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S E C R E T SECTION 1 OF 3 MANILA 3746

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E.O. 11652: GDS

TAGS: MASS, MARR, PFOR, RP

SUBJECT: SECURITY ASSISTANCE OBJECTIVES AND GUIDELINES, FY
1977 - 80: AN ASSESSMENT

REF: STATE 015489

SUMMARY: SECURITY ASSISTANCE OR AN EQUIVALENT THEREOF IS THE IMPLICIT QUID PRO QUO FOR U.S. BASE RIGHTS IN THE PHILIPPINES. THE PROGRAM HAS BEEN GENERALLY EFFECTIVE DESPITE ITS SMALL VALUE. TO COMPENSATE FOR DECLINING GRANT AID LEVELS, THE GOP HAS MADE GOOD USE OF FMS PURCHASES. SOME \$39 MILLION IN FMS SALES CASES ARE PENDING. THIS AVAILMENT OF FMS IS A POSITIVE DEVELOPMENT; IT HAS REINFORCED AFP SELF-RELIANCE OBJECTIVES AND HAS GIVEN MOMENTUM TO LOCAL PRODUCTION PROJECTS DESIGNED TO BE FINANCED BY FMS CREDITS. HOWEVER, FMS IS NOT A SUBSTITUTE FOR GRANT AID AND THE DECLINING, INFLATION-RAVAGED GRANT AID LEVEL IS BECOMING LESS EFFECTIVE AS QUID PRO QUO. A WAY NEEDS TO BE FOUND EITHER TO INCREASE THE GRANT AID LEVEL, OR TO DEVISE SOME FORM OF FIXED PAYMENT THAT WOULD HELP PROVIDE AN EQUIVALENT OF

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\$25 TO \$30 MILLION ANNUALLY IN GRANT ASSISTANCD. END SUMMARY.

1. NEED FOR SECURITY ASSISTANCE

SECURITY ASSISTANCE OR AN EQUIVALENT THEREOF IS THE IMPLICIT QUID PRO QUO FOR U.S. ACCESS TO, AND FREE USE OF, ITS MILITARY BASES IN THE PHILIPPINES, ONE OF THE MAJOR OBJECTIVES OF U.S. FOREIGN POLICY TOWARD THE GOVERNMENT OF THE PHILIPPINES (GOP). U.S. SECURITY ASSISTANCE IS NOT REQUIRED BY ANY SPECIFIC AGREEMENT FOR BASE RIGHTS, BUT BOTH COUNTRIES IMPLICITLY ACKNOWLEDGE ITS RELEVANCE TO BASE USAGE.

2. EFFECTIVENESS OF SECURITY ASSISTANCE

DESPITE ITS RELATIVELY SMALL VALUE, U.S. SECURITY ASSISTANCE HAS SO FAR BEEN EFFECTIVE, IN CONJUNCTION WITH OTHER FORMS OF ASSISTANCE, IN HELPING TO ACHIEVE THE BASIS U.S. OBJECTIVES. GRANT AID, WHICH HAS AVERAGED \$15.0 MILLION IN THE YEARS 1970-74, HAS FALLEN SHORT OF PROGRAMMED LEVELS AS RECENTLY BUT THE GOP HAS MADE VERY EFFECTIVE AVAILMENT OF THE FOREIGN MILITARY SALES (FMS) PROGRAM TO PURCHASE EQUIPMENT AND SUPPLIES TO MEET THE GRANT AID SHORTFALL. SALES ROSE FROM \$738,000 IN 1970 TO \$3.6 MILLION IN 1973 AND \$8.1 MILLION IN 1974.

3. GOP FMS PURCHASES ARE CAUSING A FORCED-DRAFT ENCOURAGEMENT OF THE PHILIPPINE SELF-RELIANCE CAPABILITY BECAUSE THE AFP IS BEING FORCED TO USE GRANT AID EXCLUSIVELY TO ADD NEW INVESTMENT ITEMS TO ITS INVENTORY AND IS MEETING VIRTUALLY ALL ITS O & M REQUIREMENTS ITSELF, PARTICULARLY THE PURCHASE OF AMMUNITION AND OTHER CONSUMABLES. WHERE NECESSARY IT HAS ALSO SUPPLEMENTED THESE ACQUISITIONS BY THIRD COUNTRY PURCHASES.

4. NOTWITHSTANDING THE GOP'S READINESS TO UTILIZE FMS TO ADVANCE ITS SELF-RELIANCE GOALS, FMS CASH AND SALES ARE INADEQUATE IN THEMSELVES TO COMPENSATE FOR DECLINING GRANT AID LEVELS IN THE FACE OF MOUNTING AFP REQUIREMENTS. AFP REQUIREMENTS, BASED ON SELF-RELIANCE DEFENSE PROGRAM OF 1971--A DIRECT BY-PRODUCT OF NIXON DOCTRINE SELF-RELIANCE TENETS--HAVE GROWN STEADILY SINCE PROGRAM INAUGURATED. EXPANSION AND STRENGTHENING OF AFP HAVE BEEN ACCELERATED RECENTLY IN RESPONSE TO HEAVY DRAIN IMPOSED BY FIGHTING IN MINDANAO. IN FACE OF THESE INCREASING DEMANDS ON STRAINED

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INTERNAL AND EXTERNAL RESOURCES, U.S. SECURITY ASSISTANCE PROGRAM HAS BEEN SUBJECTED TO SEARCHING GOP EXAMINATION.

5. OBVIOUSLY, THE GOP NEED TO COVER WITH ITS OWN FUNDS THE INCREASING SHORTFALL BETWEEN SECURITY ASSISTANCE FUNDS AND ACTUAL MILITARY REQUIREMENTS HAS CALLED INTO QUESTION THE ADEQUACY OF THE IMPLICIT QUID PRO QUO ARRANGEMENT. THE MOMENT MAY BE APPROACHING WHEN THE GOP WILL SEEK TO MAKE THIS ARRANGEMENT

EXPLICIT, AND, IN ANY EVENT, ATTEMPT TOTIE BASE RIGHTS TO A FIXED MINIMUM SUM EQUIVALENT, IN EFFECT, TO A HIGHER GRANT AID LEVEL IN THE RANGE OF TWENTY-FIVE TO THIRTY MILLION DOLLARS A YEAR. AT THE SAME TIME, THE GOP WILL BE SENSITIVE TO ANY DIMINUTION IN OTHER FORMS OF U.S. ECONOMIC ASSISTANCE, WHICH IT REGARDS AS AN INTEGRAL PART OF THE CLOSE BI-LATERAL RELATIONSHIP BETWEEN THE U.S. AND THE PHILIPPINES.

6. INTER-RELATIONSHIP AMONG VARIOUS ELEMENTS OF SECURITY ASSISTANCE

SECURITY ASSISTANCE IS A MIX OF GRANT AIDS, FMS SALES, FMS CREDITS AND EXCESS DEFENSE ARTICLES (EDA) AVAILABILITIES. PROVIDED GRANT AID CAN BE MAINTAINED AT A MINIMALLY EFFECTIVE LEVEL AND CAN BE SUPPLEMENTED BY SUBSTANTIAL FMS AND EDA COMPONENTS, THE PROGRAM CAN CONTINUE TO BE USED TO MEET IMMEDIATE, PRESSING NEEDS, BUILD UP THE INVESTMENT INVENTORY AND FOSTER CONTINUED DEVELOPMENT OF THE SELF-RELIANCE TREND. INDEED, WE FORECAST THAT THE PORTION OF THE PHILIPPINE SELF-FINANCED DEFENSE EXPENDITURES WILL REACH 95 PERCENT IN THE PLANNING PERIOD. THIS WILL REQUIRE, HOWEVER, A JUDICIOUS BLENDING AND CONTINUED AVAILABILITY OF APPROXIMATELY THE PRESENT SCALE OF EXTERNAL ECONOMIC SUPPORT, IN ADDITION TO SECURITY ASSISTANCE.

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A. IMPACT OF U.S. ECONOMIC ASSISTANCE

THE MAJOR IMPACT OF OTHER U.S. ECONOMIC ASSISTANCE IS THAT IT SUPPLEMENTS THE RESOURCES OF THE GOVERNMENT AND THEREFORE HELPS THE GOP TO FUND THE GREAT BULK OF ITS DEFENSE EXPENDITURES OUT OF LOCAL REVENUES. IT STRENGTHENS THE ECONOMY AS A WHOLE IN TERMS OF FOREIGN EXCHANGE AVAILABILITY AND CHANNELS SUCH FUNDS IN TERMS OF LOCAL CURRENCY EQUIVALENT INTO DEVELOPMENTAL ACTIVITY. NEVERTHELESS, ECONOMIC ASSISTANCE DOES NOT HAVE THE DIRECT EFFECT OF DEDICATED SECURITY ASSISTANCE MONIES AND AVAILABILITIES. ALTHOUGH PHILIPPINE NEED TO FINANCE MILITARY IMPORTS RECENTLY HAS BEEN GROWING RAPIDLY, AS NOTED. THE PHILIPPINES HAS BEEN FUNDING AN INCREASINGLY LARGE SHARE OF ITS MILITARY IMPORTS FROM ITS OWN FOREIGN EXCHANGE RESOURCES.

GRANT AID AND FMS, FY-1969-1975 (MILLIONS)

	1969	1970	1971	1972	1973	1974	1975
GRANT AID	18.9	15.6	16.5	16.0	12.6	13.8	UNFUNDED
FMS(CASH)	.212	.841	1.3	2.3	3.8	8.1	7.6
FMS(CREDIT)	0	0	0	0	0	8.6	7.0

(NOTE: FIGURES FOR FY-1974 REPRESENT ACTUAL DRAW DOWNS; FIGURES FOR FY-1975 ARE COMMITTED OR FAIRLY FIRM PROSPECTIVE COMMITMENTS. THERE ARE ANOTHER \$30 MILLION FMS CASES

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PENDING DECISIONS IN 1975.)

THE AFP RESPONSIBILITY IS LARGE AND GROWING AND ITS SHARE OF THE BUDGET HAS INCREASED FROM ABOUT ONE PERCENT OF GNP IN 1971 TO THREE PERCENT IN 1974. GIVEN THE DIVERSE POLITICAL-MILITARY ROLES THE AFP IS PRESENTLY BEING CALLED UPON TO PERFORM UNDER MARTIAL LAW AND ITS EXPANDING ROLE IN ECONOMIC DEVELOPMENT, IT SEEMS CLEAR GOP DEFENSE EXPENDITURES WILL CONTINUE TO GROW. U.S. ECONOMIC ASSISTANCE WILL CONTINUE TO ASSIST THE ABILITY OF THE ECONOMY TO ABSORB MOUNTING DEFENSE COSTS. OBVIOUSLY, CUTS IN SUCH ASSISTANCE UNDER PRESENT CIRCUMSTANCES WOULD PROBABLY MEAN CURTAILMENT OF SOME DEVELOPMENT PROJECTS IN DEFERENCE TO MORE PRESSING DEFENSE NEEDS-WITH POSSIBLY ADVERSE IMPACT ON ECONOMIC GROWTH AND POLITICAL STABILITY.

B. AN EVALUATION OF THE IMPACT ON SA REQUIREMENTS

OF THIRD COUNTRY MILITARY ASSISTANCE

(1) GOVERNMENT TO GOVERNMENT. THIRD COUNTRY MILITARY ASSISTANCE TO THE PHILIPPINES IN THE PAST HAS BEEN SMALL. IT HAS BEEN LIMITED TO JAPANESE REPARATIONS, SOME MINOR EQUIPMENT TRANSFERS FROM OTHER COUNTRIES AND VARIOUS RECIPROCAL ARRANGEMENTS FOR MILITARY SCHOOLING. BY FAR THE LARGEST COMPONENT HAS BEEN JAPANESE REPARATIONS WHICH WILL TOTAL ABOUT \$100 MILLION OVER THE TWENTY-YEAR PERIOD THAT TERMINATES IN 1976. FOR THE LAST FEW YEARS THE AMOUNT HAS

BEEN ABOUT \$10 MILLION A YEAR AND HAS BEEN DISTRIBUTED MOSTLY TO THE PHILIPPINE CONSTABULARY (PC) AND OTHER POLICE FORCES. JAPANESE REPARATIONS HAVE ALSO PROVIDED FOR A SUBSTANTIAL PORTION OF THE FORESIGHT SIERRA COMMUNICATIONS SYSTEM. RECENTLY, JAPAN ALSO GAVE SEVERAL SMALL PATROL AND RESCUE CRAFT TO THE PHILIPPINE NAVY. THE TERMINATION OF THIS ASSISTANCE AFTER FY 76 WILL CONSEQUENTLY IMPACT ON SECURITY ASSISTANCE (UNLESS THE JAPANESE DECIDE TO CONTINUE AIDING THE PC). OTHERWISE, THE GOP WILL HVE TO COMPENSATE FOR THE SHORTFALL THROUGH FMS CHANNELS, OR THIRD COUNTRY AVAILMENTS.

THE AMOUNT OF MILITARY EQUIPMENT TRANSFERS FROM SOURCES OTHER THAN JAPAN ARE VERY SMALL AND HAVE HAD A NEGLIGIBLE EFFECT ON THE PROGRAM.

(2) GOP PURCHASES FROM THIRD COUNTRIES. THROUGH FY-73 AND 74, GOP PURCHASES OF MILITARY EQUIPMENT AND SUP-
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PLIES FROM THIRD COUNTRY SOURCES INCREASED IN ABOUT THE SAME MANNER AS U.S. FMS SALES. HOWEVER, SUCH PURCHASES DECLINED CONSIDERABLY IN FY-75, PRESUMABLY AS A RESULT OF THE INCREASED RESPONSIVENESS OF THE FMS SYTEM (\$39 MILLION IN FMS SALES CASES IS PENDING); THE DECLINE ALSO REFLECTS A DEGREE OF GOP DISENCHANTMENT WITH ITS BUYING EXPERIENCES FROM THIRD COUNTRIES. THE GOP PREFERS TO BUY AMERICAN EQUIPMENT BECAUSE OF ITS FAMILIARITY, HIGH QUALITY, DEPENDABILITY AND DEPENDABLE U.S. MAINTENANCE SUPPORT. NEVERTHELESS, WHEN U.S. EQUIPMENT IS UNAVILABLE OR THE U.S. RESPONSE IS TOO SLOW, THE GOP HAS DEMONSTRATED IT WILL BUY EQUIPMENT WHERE IT CAN.

THIRD COUNTRY PURCHASES COMPARED WITH FMS SALES CASES(MILLIONS)

	THIRD COUNTRY	FMS
FY-73	\$ 1.7	\$ 3.8
FY-74	7.4	8.1
FY-75	2.5	7.6
	11.6	19.5

(3) MILITARY SCHOOLING. THE TREND TOWARDS DIVERSIFICATION OF MILITARY SCHOOLING, ESPECIALLY AVAILMENT OF THIRD COUNTRY RECIPROCAL SCHOOLING AGREEMENTS, HAS HAD AN IMPACT ON THE TRAINING PORTION OF SECURITY ASSISTANCE. CONTINUED U.S. FINANCING OF WIDE-SCALE TRAINING OPPORTUNITIES IN THE U.S. WILL BE NECESSARY TO MAINTAIN U.S. INFLUENCE IN THE PHILIPPINE ARMED FORCES. THIS HAS BEEN A VERY VALUABLE PROGRAM IN THE PAST AND AS THE AFP EXPANDS AND TAKES ON NEW, MORE POLITICAL ROLES, RETENTION OF AN EFFECTIVE U.S. TRAINING PROGRAM WILL GROW IN IMPORTANCE.

C. IMPACT OF THIRD COUNTRY ECONOMIC ASSISTANCE
ONLY JAPAN IS A MAJOR THIRD COUNTRY ECONOMIC ASSISTANCE

DONOR TO THE PHILIPPINES. THIS ASSISTANCE HAS BEEN INITIALLY IN THE FORM OF REPARATIONS PAYMENTS BUT PRESENTLY INCLUDES LOANS OF \$50 - \$80 MILLION YEARLY. REPARATIONS HAVE IMPACTED ON MANY SECTORS, BUT HAVE BEEN PARTICULARLY NOTEWORTHY RE THE PHILIPPINE CONSTABULARY. THE \$10 MILLION ANNUALLY THE PC HAS RECEIVED HAS PAID FOR A LARGE PORTION OF ITS FOREIGN EXCHANGE-FUNDED PURCHASES. AS NOTED, THE REPARATIONS PROGRAM ENDS IN 1976.

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D. IMPACT OF ASSISTANCE PROVIDED BY INTERNATIONAL FINANCIAL INSTITUTIONS

THE PHILIPPINES RECEIVES SUBSTANTIAL AMOUNTS OF ECONOMIC ASSISTANCE FROM INTERNATIONAL DONORS. THE BASIC MECHANISM IS A CONSULTATIVE GROUP (CG) LED BY THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (IBRD) -- WHICH, ITSELF, IS THE LARGEST DONOR TO THE PHILIPPINES. OTHER CG MEMBERS ARE JAPAN, THE U.S., THE ASIAN DEVELOPMENT BANK, THE UNITED NATIONS DEVELOPMENT FUND, AND SEVERAL COUNTRIES WITH RELATIVE SMALL SHARES IN CONSORTIUM ACTIVITIES. ALTOGETHER THESE DONORS PROVIDE ON A COMMITMENT BASIS UPWARD OF \$425 MILLION ANNUALLY IN ECONOMIC ASSISTANCE TO THE PHILIPPINES, WITH THE U.S. PROVIDING A LITTLE OVER 15 PERCENT OF THE TOTAL. THE ECONOMIC IMPACT OF THIS ASSISTANCE IS THAT IT HELPS TO PROVIDE IMMEDIATELY NEEDED INFRASTRUCTURAL GROWTH; IT ALSO HELPS

TO MEET THE EXTERNAL ACCOUNT DEFICIT AND TO STRETCH OUT THE
STRUCTURE OF EXTERNAL DEBT.

AT THE END OF 1974 GOP EXTERNAL DEBT WAS \$3,210 MILLION,
REFLECTING AN INCREASE OF \$852 MILLION OR 36 PERCENT OVER
THE 1973 YEAR-END LEVEL. GROSS INTERNATIONAL RESERVES ROSE
TO \$1,150 MILLION, MORE THAN 31 PERCENT OVER THAT OF 1973,
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BUT NET RESERVES DECLINED. THERE WAS A 31 PERCENT INCREASE
IN BORROWING IN 1974, MAINLY TO OFFSET IMPORT PRICE INCREASES,
WHICH RAISED THE DEBT SERVICE BURDEN TO ABOUT 20 PERCENT
OF CURRENT ACCOUNT EARNINGS. THE DEBT SERVICING CAPABILITY
OF THE GOP WILL BE SEVERELY STRAINED OVER THE NEXT FEW YEARS
IF THIS PACE OF BORROWING CONTINUES, ESPECIALLY IF THE SLOWDOWN IN
ECONOMIC ACTIVITY CONTINUES IN THE MAJOR MARKETS FOR PHILIPPINE
EXPORTS. IN THE EVENT INFLOWS FROM INTERNATIONAL FINANCIAL INSTI-
TUTIONS DIMINISH SIGNIFICANTLY, THE CONTRACTION EFFECTS MAY
IMPACT ON THE AFP BUDGET PROMPTING REQUESTS FOR INCREASED
SECURITY ASSISTANCE OR ACCELERATED DELIVERY OF EARLIER
PROGRAMMED ITEMS.

7. SIGNIFICANT TRENDS IN HOST-COUNTRY SELF-SUFFICIENCY IN
DEFENSE FINANCE AND PROCUREMENT

OVER THE PERIOD OF FY-77 TO 80, THE AFP BUDGET IS EXPECTED
TO INCREASE FROM \$488.4 MILLION TO \$624.9 MILLION, REPRESENTING 3 AND 3.1 PERCENT RESPECTIVELY OF PROJECTED GNP FOR THE PHILIPPINES. FMS CASH PURCHASES FOR MAJOR ITEMS AND WEAPONS IN THE PERIOD, MAY REACH \$30 MILLION AND OPERATIONS AND MAINTENANCE FMS CASES EXPENDITURES WILL PROBABLY REACH \$40 TO \$45 MILLION. FMS CREDIT PURCHASES OF UP TO \$50 MILLION IN TOTAL VALUE THEORETICALLY COULD BE SUPPORT EACH FY OF THE PLANNING PERIOD.

8. THE SIGNING OF THE US-RP AGREEMENT FOR THE BUILDING OF
A COLT M-16 RIFLE PLANT FINANCED BY A \$15.6 MILLION FMS
CREDIT WAS A MAJOR MILESTONE IN THE HISTORY OF THE SECURITY
ASSISTANCE PROGRAM IN THE PHILIPPINES. IT REPRESENTED A
SIGNIFICANT STEP TOWARD REALIZATION OF SELF-RELIANCE OBJECTIVES.
WE ESTIMATE THAT CONCRETE GOP INTEREST IN FMS CASH AND
CREDIT FOR PURCHASES OF U.S. MILITARY EQUIPMENT AND TECHNOLOGY NOW TOTALS MORE THAN \$90 MILLION. IN ADDITION TO THE FACT THAT GOP USE OF FMS FOR THE COLT PLANT HAS ENHANCED THE COMPLEMENTARITY OF SECURITY ASSISTANCE OBJECTIVES WITH GOP SELF-RELIANCE OBJECTIVES, THE FMS BREAKTHROUGH HAS ALSO PLAYED A ROLE IN ENCOURAGING THE GOP TO EXPAND ITS OVERALL IN-COUNTRY CAPABILITY TO PRODUCE DEFENSE ARTICLES. THE SELF-RELIANCE DEFENSE POSTURE (SRDP) PROGRAMS INITIATED IN 1973 AND 1974 ARE DESIGNED TO ATTAIN SELF-RELIANCE IN AN ORDERLY

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MANNER BASED ON FMS SALES-PROCURED TECHNICAL DATA PACKAGES FOR SMALL ARMS MANUFACTURE, AMMO PRODUCTION, RADIO PRODUCTION AND A WIDE VARIETY OF OTHER PROJECTS DESIGNED TO INTERFACE WITH LOCAL INDUSTRY. THERE IS THUS AN INTIMATE CONNECTION BETWEEN THE NASCENT, BUT GROWING PHILIPPINE SELF-RELIANCE CAPABILITY AND THE ABILITY OF THE SECURITY ASSISTANCE PROGRAM TO PROVIDE NEEDED EQUIPMENT AND TECHNOLOGY.

9. CONCLUSIONS:

A. THERE IS A NEED FOR U.S. SECURITY ASSISTANCE IN TERMS OF MEETING AFP MODERNIZATION, SELF-RELIANCE AND EXPANSION OBJECTIVES AND FULFILLING THE INTERNAL SECURITY REQUIREMENTS.

B. THERE IS AN ADDITIONAL NEED FROM THE POINT OF VIEW OF THE INCREASINGLY IMPORTANT ROLE THE AFP IS PLAYING IN DEVELOPMENT, CIVIC ACTION AND OTHER POLITICAL-MILITARY ROLES.

C. THERE IS A PARTICULAR NEED FOR TRAINING ASSISTANCE WHICH IS A VERY KEY ELEMENT FOR US-RP RELATIONS IN THE FUTURE, ASSUMING A CONTINUATION OF MARTIAL LAW.

D. WHILE U.S. ECONOMIC ASSISTANCE DOES NOT DIRECTLY SUBSTITUTE FOR SECURITY ASSISTANCE IN PHILIPPINE EXPECTATIONS OR IN PRACTICAL AFP BUDGET PLANNING, IT PLAYS AN IMPORTANT ROLE, ALONG WITH OTHER BILATERAL AND MULTILATERAL ASSISTANCE, IN SUPPORTING THE VIABILITY OF THE CONOMY AND THEREBY POLITICAL STABILITY.

E. THE SECURITY ASSISTANCE PROGRAM IS BECOMING LESS EFFECTIVE IN SO FAR AS ITS SERVICE AS A QUID PRO QUO FOR THE BASES BECAUSE IT IS STEADILY DECLINING IN AMOUNTS AND INFLATION IS TAKING A HEAVY TOLL. INCREASED GOP USAGE OF FMS HAS HELPED TAKE THE PRESSURE OFF GRANT AID TO SOME DEGREE; HOWEVER, SALES CANNOT SUBSTITUTE FOR GRANTS. THE U.S. MUST EITHER FIND A WAY OF INCREASING SECUIRTY ASSISTANCE GRANTS, OR, FAILING THAT, DEVISE SOME OTHER FORM OF FIXED PAYMENT THAT WOULD HELP PROVIDE AN EQUIVALENT OF \$25-\$30 MILLION ANNUALLY IN GRANT ASSISTANCE.

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: SECURITY, MILITARY ASSISTANCE PROGRAMS, FOREIGN ASSISTANCE, MILITARY SALES, MILITARY BASES
Control Number: n/a
Copy: SINGLE
Draft Date: 25 MAR 1975
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: MartinML
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1975MANILA03746
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Film Number: D750103-0669
From: MANILA
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1975/newtext/t19750318/aaaaaqgo.tel
Line Count: 430
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION PM
Original Classification: SECRET
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 8
Previous Channel Indicators: n/a
Previous Classification: SECRET
Previous Handling Restrictions: n/a
Reference: 75 STATE 015489
Review Action: RELEASED, APPROVED
Review Authority: MartinML
Review Comment: n/a
Review Content Flags:
Review Date: 23 JUL 2003
Review Event:
Review Exemptions: n/a
Review History: RELEASED <23 JUL 2003 by ElyME>; APPROVED <19 NOV 2003 by MartinML>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
05 JUL 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: SECURITY ASSISTANCE OBJECTIVES AND GUIDELINES, FY 1977 - 80: AN ASSESSMENT
TAGS: MASS, MARR, PFOR, RP, US
To: STATE
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 05 JUL 2006